88-1066

Supreme Court, U.S.
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No.

In The Supreme Court of The United States
October Term 1988

ESTATE OF GEORGE JOHNSON, ELEANOR MADSEN, CARMEN COLON, CASIMIRA MACIAS, SOLEDAD FREGOSO, MANUEL COLON, HILDA VALDES, CARMEN REGALADO, AMERICA SUAREZ, FERDINAND KANGISER, MARIA ROMERO, RAFAEL MENDOZA, JOSE LUIZ CORONA, HERIBERTO PIZZARO, RAMON GONZALAS, AND GUILLERMINA OLIVARES,
For Themselves and all Participants in the Reliable Profit Sharing Plan Trust except CHARLES W. LEIGH AND ERVIN F. DUSEK, the Plaintiffs.

Petitioners

v.

CLYDE WILLIAM ENGLE, NATHAN DARDICK, RONALD ZUCKERMAN, LIBCO CORPORATION, TELCO MARKETING SERVICES, INC., TELVEST, INC., THE RELIABLE EMPLOYEES' PROFIT SHARING PLAN TRUST, AND NATIONAL BOULEVARD BANK OF CHICAGO, A National Banking Association.

Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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QUESTION PRESENTED

WHETHER, UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT, FIDUCIARIES AND PARTIES IN INTEREST WHICH ENGAGE IN PROHIBITED TRANSACTIONS WITH ASSETS OF A QUALIFIED EMPLOYEE PROFIT SHARING PLAN ARE ENTITLED TO RETAIN ALL THEIR PROFITS FROM THE PROHIBITED TRANSACTIONS, RATHER THAN TO DISGORGE THEM TO THE PLAN IN ORDER TO INSURE THE CONGRESSIONAL PURPOSES OF HONEST AND FAITHFUL MANAGEMENT OF QUALIFIED EMPLOYEE BENEFIT PLANS?

LIST OF PARTIES

The parties to the proceedings below were CHARLES W. LEIGH and ERVIN DUSEK, the Plaintiffs[1], participants having funds in the Reliable Manufacturing Corporation Employees' Profit Sharing Plan. The Petitioners before this Court are the INTERVENING PLAINTIFFS, individually and as representatives of the certified class of participants, having funds in the Reliable Manufacturing Corporation Employees' Profit Sharing Plan, except CHARLES W. LEIGH and ERVIN DUSEK, the Plaintiffs.

The respondents before this Court are all the defendants in the court below.

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[1] Plaintiffs did not pursue their appeal in the court below.

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TO THE UNITED STATES COURT OF APPEALS
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The Petitioners, Estate of George Johnson, et. al., etc., respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit, entered in the above-entitled proceedings on September 21, 1988, as amended September 30, 1988.

OPINIONS BELOW

The opinion of the Court of Appeals for the Seventh Circuit is reported at 858 F.2d 361, and appears in the appendix hereto, p.1a. The Findings of Fact, Conclusions of Law and Judgment of the Northern District of Illinois (Duff, D.J.) is reported at 669 F.Supp. 1390 (N.D.Ill. 1987). It appears in the appendix hereto, p.21a. A memorandum and order of the Northern District of Illinois (Moran, D.J.) is reported at 619 F.Supp. 154 (N.D.111.,1985). It appears in the appendix hereto, p.79a. An unreported order of the Seventh Circuit entered May 30, 1985, appears in the appendix hereto, p.93a. The primary opinion of the Court of Appeals for the Seventh Circuit ("Leigh I") is reported at 727 F.2d 113, and appears in the appendix hereto, p.95a. A Memorandum, Findings of Fact, Conclusions of Law, and Judgment of the Northern District, entered November 18, 1982, is unreported. It appears in the appendix hereto, p.148a.

JURISDICTION

Invoking federal jurisdiction under 29 U.S.C. Section 1132, petitioners intervened in plaintiffs' action in the Northern District of Illinois. On November 18, 1982, the Northern District of Illinois entered judgment against petitioners from which a timely appeal was taken. On March 20, 1984, the Seventh Circuit vacated and remanded this judgment.

On August 27, 1987, the Northern District of Illinois entered findings of fact and conclusions of law in a memorandum decision and a judgment. Petitioners appealed to the Seventh Circuit which affirmed the Northern District of Illinois on September 21, 1988, as amended September 30, 1988. No Petition for Rehearing was sought.

The jurisdiction of this Court to review the judgment of the Seventh Circuit is invoked under 28 U.S.C. Section 1254(1).

STATUE INVOLVED

29 U.S.C. Section 1109 (a) Liability For Breach of Fiduciary Duty (a) Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. A fiduciary may also be removed for a violation of section 1111 of this title.

STATEMENT OF THE CASE

Petitioners are seventeen former employees of the Reliable Manufacturing Company having fully vested rights in the Reliable Profit Sharing Trust. Invoking federal jurisdiction pursuant to the Employee Retirement Income Security Act, 29 U.S.C. Section 1132, they obtained leave to intervene in a suit initiated by plaintiffs under the same federal statute, both individually and as representatives of a class of persons who had funds in the profit sharing plan when the company ceased doing business in February 1979. Petitioners sought to impose additional liability and to recover all respondents' profits and any losses to the trust from respondents' improper and unauthorized use of vested and non-forfeitable funds pursuant to 29 U.S.C. Section 1109(a).

The essential facts material to the consideration of the question presented are not in dispute. To be concise, the Reliable Trust was created by Reliable Manufacturing Company in 1968 as a qualified employees' profit sharing trust and became subject to the Employee Retirement Income Security Act of 1974. The plaintiffs were the trust administrators until September 15, 1977, when they were replaced by Reliable's Board of Directors, of which Clyde

William Engle was chairman, with Nathan Dardick and Ronald Zuckerman.[2] Until March 1978, all trust assets were held in the form of fixed income money market investments.

In late March 1978, at the same time other members of the "Engle group" were purchasing substantial amounts of stock in Berkeley Bio Medical, Inc. ("Berkeley"), Hickory Furniture Company ("Hickory"), and Outdoor Sports Industries, Inc. ("OSI"), Nathan Dardick used 30% of the trust's assets to purchase stock in the same companies.

Dardick's investments in Berkeley and OSI earned substantial profits for the trust of 66% and 141%, respectively. His investment in Hickory produced only a net profit of 4%, including a loss on one third of the shares he purchased. The trust's aggregate return on these three investments was 72%. Appendix 27a and 103a. Likewise, the profits of the Engle Group on its funds invested in Berkeley and OSI, before and after the trust investments were substantial. On October 7, 1980, the "Engle group" owned 52.8% of Hickory. Petitioners presented evidence in the Northern District of Illinois that the Engle Group earned a total profit on these three investments of $9,825,198.00. Record, PX 412, pages 21-24, 26-29; PX 258-260.

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[2] Plaintiffs, Charles Leigh and Ervin Dusek, the former owners of Reliable Manufacturing Company sold Reliable to Libco, a holding company substantially owned and controlled by Engle in April 1977. Dardick is an attorney who was retained as personal counsel to Engle in 1978 and 1979. He was also general counsel to Libco, Telco, Telvest, GSC, the Bank of Lincolnwood and Sierra, all of which are a group of individuals and business entities with close connections to Engle. Zuckerman was a board member and investment consultant to Libco. The Seventh Circuit on occasion referred to Engle, Libco, Telco, Telvest, Dardick and Zuckerman as the "the Engle group." because the complex network of legal and financial relationships among them was central to its decision in Leigh I. Appendix 96a-99a.

The case was tried to the Northern District Court and after an extended bench trial, the Court (Leighton, D.J.) entered 23 pages of findings of fact and conclusions of law holding that Engle and Libco were not fiduciaries, that Dardick's investments were prudent, that the plan had sustained no loss or damage as a result of the plan investments made by Dardick, that the plan assets were used exclusively in petitioners' interest, that the plan trustee and administrators acted properly and reasonably in the partial termination of the plan, that any delay in distributing benefits was due to Reliable's bankruptcy proceedings, litigiousness, and the emotional involvement of plaintiffs' lawyer, that respondents' profits were made through the use of their own assets and no basis exists on which to require them to surrender their profits, Dardick and Zuckerman did not engage in prohibited transactions nor breach their duty to the plan, Telco and Telvest are "parties in interest", and ERISA creates no cause of action where the plan was not damaged.

The Seventh Circuit vacated and remanded this case, observing in its primary opinion "Leigh I", "The heart of the case is a dispute over how ERISA governs the actions of plan administrators and other fiduciaries with respect to investment activities in contests for corporate control." Appendix 96a. It decided that Dardick's investments of trust assets in target corporations in order to assist Engle and Libco in their quest for corporate control of a "control premium" were prohibited transactions in violation of Section 1106(a)(1)(D). The timing of the trust purchases of Berkeley stock in relation to other actions of the "Engle group shows that the trust assets were not used exclusively to further the interests of the trust beneficiaries. In particular, although the Engle group faced the danger of being "locked-in" as minority shareholders under hostile management in late February 1978, Engle increased his investment and purchased additional shares. Meanwhile, Dardick invested the trust's assets in the same company

making the Reliable Trust one of the minority shareholders. In June 1978, the Engle Group reached a settlement of its control contest, and Dardick sold the Reliable Trust shares as part of the settlement which called for the payment of a substantial premium.

The Reliable Trust investments in OSI showed a similar pattern. Dardick made the trust investment very early in the struggle for control of OSI. Throughout the period of purchases by the Engle Group and its fight for control of OSI, the Reliable Trust held its investment, even after Reliable's bankruptcy and the termination of its profit sharing plan trust. Throughout this period, Dardick was forcing OSI's management to yield control or to purchase the Engle group's shares at a premium. Ultimately, the trust's shares were sold for an enormous profit.

This similar pattern again was displayed in Hickory, although Hickory management decided not to resist the Engle group's efforts to gain its control. Dardick made and held the trust's investment until it became clear that the Engle group would be successful in its acquistion efforts. After it was clear that the Engle group would succeed, the trust's shares were sold at a low point in the market for a net profit of 4%, including a loss on one-third of the shares it purchased.

Concluding that Dardick and Zuckerman violated their fiduciary duties under Section 404(a), Section 406(a)(l)(D) and Section 406(b)(l) of ERISA by their investments in the Engle Group's takeover targets, the Seventh Circuit considered the liability of Engle and Libco. Engle and Libco were fiduciaries with respect to the selection and retention of Dardick and Zuckerman. Finding that their fiduciary duty extended to the trust investments, the Seventh Circuit remanded for the Northern District to determine whether Engle and Libco fulfilled their duties, reasonably and prudently in light of their knowledge that Dardick and Zuckerman faced conflicting loyalties with respect to the

trust's investments in the target companies. The Seventh Circuit held petitioners did not prevail on the merits against Telco and Telvest, the parties in interest, whose interests Dardick aided by the plan investments.

The Seventh Circuit also considered the Northern District's inconsistent findings of fact and conclusions of law pertaining to termination of the Reliable Trust. It vacated and remanded the issue of when the Reliable Trust terminated and whether respondents violated their fiduciary duties regarding termination and by delaying distribution of the plan assets while seeking to make distribution contingent on release from liability in this lawsuit.

It held that the respondent fiduciaries Dardick and Zuckerman breached their fiduciary duties and engaged in prohibited transactions and that petitioners had not prevailed on the merits against Telco and Telvest. The parties in interest. The Seventh Circuit remanded to the Northern District the formidable task of finding an appropriate measure of damages, if any. In doing so, the Seventh Circuit observed that petitioners contention, that they are entitled to all profits of the respondents in their own investments in Berkeley, OSI and Hickory, reaches too far. Section 1109, it held requires only all profits "made through use of assets of the plan" in order to establish a causal connection between the use of the plan assets and respondents' profits, if any. Since the trust investments in the target companies relative to respondents' investments are relatively small, the Seventh Circuit expressed its concern that were petitioners to recover all respondents' profits, the recovery could double or triple the size of the trust. Further, since ERISA is silent on how profits should be apportioned, the Seventh Circuit established a legal standard analogous to the apportionment of a copyright infringer's profits. With respect to the issue of burden of proof in such apportionment cases, this case was similar

to the common law problem in which a trustee commingles trust assets with his or her own so that it is difficult to discern which property and profits belong to whom.

Upon remand, arguments ensued on the legal standard that the Court of Appeals intended as the applicable standard since, it had referred to disgorgement as one remedy that Congress had intended. Appendix 110a. A petition to recall the mandate was denied and on June 27, 1985, the Northern District expressed the view urged by petitioners. Appendix 88a.

After concluding the remand trial of "Leigh I" the Northern District held that Engle and Libco violated their fiduciary duties only with respect to the trust investments and not with respect to delaying distribution of the trust assets. The Reliable Trust terminated on March 1, 1979, the date petitioners were layed off. Since Dardick and Zuckerman made distributions of trust assets in 1980 of approximately $1,000,000.00, the Northern District ruled that under the trust instruments there had been no delayed distribution of trust benefits. Likewise, the Northern District ruled that complete distribution of trust assets was not required since, Dardick and Zuckerman were entitled to retain trust assets in order to reimburse themselves for the expenses of this litigation.

The Northern District resolved the issue of respondents' profits against petitioners by reasoning that in order to avoid disgorgement of part of its profits, the respondents had to show that they did not result from misuse of trust assets. According to its analysis of the evidence, respondents met this burden and respondents were entitled to retain all their profits. The Northern District further held that respondents had caused a loss with respect to the Reliable Trust's Hickory investment and awarded the trust $6,704.00. A fee award was adjudged against respondents in part to sanction respondents for the prohibited

transactions and respondents were awarded fees pursuant to the Reliable Trust instruments.

On appeal, petitioners urged the Seventh Circuit to hold that the Northern District did not follow its mandate with respect to respondents' profits. Affirming the Northern District, the Seventh Circuit found that Judge Duff did an admirable job with the damage calculation which it called a formidable task. Petitioners claim that all or most of the respondents' profits from its investments in the three companies were attributable to the prohibited transactions and mismanagement of trust assets was rejected on the basis of Leigh I since it reaches too far. The Seventh Circuit's holding is that ERISA Section 1109 only allows recovery "where there is a causal conection between the use of the plan's assets and the profits made by fiduciaries on the investment of their own assets" regardless of respondents' prohibited transactions; and, given the investments' excellent returns and the miniscule percentage of the respondent's total investment made up of trust assets, petitioners are in no way entitled to that windfall since it results from respondents' own efforts.

In arriving at its holding, the Seventh Circuit agreed with the Northern District's determination that Dardick and Zuckerman did not have the potential to undermine the Engle Group's settlement in Berkeley, and respondents profits in OSI and in Hickory likewise were earned only through respondents' large investment and by their efforts. It therefore affirmed the Northern District, noting that while the fiduciaries did not err slightly in their attempt to create a proper portfolio – rather they simply made no such attempt – and, that while there is no way to overdeter such conduct, no matter how profitable the end result, the petitioners' appeal on damages lacked merit.

REASONS FOR GRANTING THE WRIT

I. THE SEVENTH CIRCUIT DECISION AFFIRMING THE DENIAL OF REMEDIAL RELIEF TO ERISA PLAN BENEFICIARIES FROM PROHIBITED TRANSACTIONS IS AN IMPORTANT FEDERAL QUESTION WHICH HAS NOT BEEN SETTLED BY THIS COURT BUT WHICH IS PROBABLY IN CONFLICT WITH EXISTING APPLICABLE DECISIONS OF THIS COURT

Review of the lower court's ruling affirming the Northern District's denial of remedial relief from prohibited transactions is essential because of the lower court's finding of prohibited transactions by the plan fiduciaries. The decision involves an important federal question which has not been settled. *Massachusetts Mutual Life Insurance Company v. Russell, 473 U.S. 134, 105 S.Ct. 3085, 87 L.Ed 2d 96 (1985).* This Court specifically left open the type of questions presented by the lower court's decision in this case. There the questions concerned, the extent to which Section 1109(a) allows extra-contractual compensatory or punitive damages to the plan. In the lower court's ruling affirming the Northern District's decision, one of the questions raised concerns its finding of prohibited transactions without disgorgement of all profits and restoration to such plan of all such profits of the fiduciary. That result thereby raises a question unsettled by this Court which is whether the appropriate interpretation and application of other equitable relief expressed in Section 1109(a) requires disgorgement of respondents' profits in order to effectuate the purposes of ERISA.

The Northern District's opinion, as affirmed by the lower court, squarely rejects any basis for punitive damages in its interpretation of Section 1109(a). Moreover, it also rejects "such other equitable or remedial relief as the court may deem appropriate", specifically provided by Section

1109(a) as the basis for disgorgement of profits. These two remedies of punitive damages and other equitable or remedial relief possess a common attribute but exist for different purposes. Punitive damages deter and punish. *Sommers Drug Stores v. Corrigan Enterprises, Inc., 793 F.2d 1456, 1463 (5th Cir. 1986), cert. den. 107 S.Ct. 1298.* Disgorgement of profits, as other equitable or remedial relief deters and restores profits of the breaching fiduciary to the plan that must be appropriately restored in order that the purposes of ERISA remain vital. The lower court's engrafting of a concept of factual causation, and not legal causation, onto its finding of prohibited transactions makes the result that is reached in this case probably in conflict with existing applicable decisions of this Court. This is because the Northern District predicated its findings and conclusions upon the factual causation standard from copyright law that the Seventh Circuit first established by its mandate in Leigh I, and not upon the legal causation standard of accepted trust law that follows the *per se* type of finding of 1106(a)(1)(D) liability made by the Seventh Circuit.

The decisions of this Court teach an application of the standard of legal causation that repeatedly rejects factual causation when a breach of fiduciary duty is found to exist. *Magruder v. Drury, 235 U.S. 106, 35 S.Ct. 77, 59 L.Ed. 151 (1914)* holds a trustee can make no profit out of his trust regardless of whether the trust benefits or loses. This duty it was found springs from the trustee's duty and his relationship to the estate or trust or, as here, the Plan. *Mosser v. Darrow, 341 U.S. 267, 71 S.Ct. 680, 95 L.Ed 927 (1951)* reversed the Seventh Circuit and surcharged Darrow when he authorized his appointees and subordinates to trade and buy up bonds of debtor subsidiaries. It rejected the Seventh Circuit's reasoning that the surcharge created a very heavy liability upon a man who enjoyed no personal profit and that Darrow's breach of duty must be condoned so as not to strike terror into mankind. Given the effective

ways in which a trustee may effectively protect himself and further his recourse to the courts for instructions, this Court held it was appropriate to surcharge such misuse and mismanagement of one's trust. *Snepp v. U.S.. 444 U.S. 507, 100 S.Ct. 763, 62 L.Ed 2d 704 (1980)* reversed a lower court, finding that a constructive trust and disgorgement were required and appropriate where the fiduciary employee failed to obtain a review of confidential and classified material prior to publication.

The meaning of appropriateness found in this Court's decisions when used by this Court teaches lawyers and federal courts that the word has no relationship to the facts giving rise to the breach of duty except one, and that is that there was a breach of the fiduciary's duty. The only relevant fact is whether a breach of duty occurred and whether the public purposes embodied in the applicable law should be enforced. *Porter v. Warner, 328 U.S. 395, 400, 66 S.Ct. 1086, 90 L.Ed. 1332 (1945).* The lower court twice found respondents engaged in prohibited transactions; yet, it affirmed the denial of the disgorgement of the breaching fiduciaries' profits over a misplaced concern that the plan would recover a "windfall" in the event disgorgement was allowed.

The actual conflict with decisions of this Court arise from the engrafting into Section 1109(a), the factual causation standard of copyright law as the means by which the Northern District had to address the prohibited transaction. In doing this the remedial purposes of ERISA to correct the prohibited transaction were placed in jeopardy. The lower court probably misunderstood the language of Section 1109(a) "and shall be subject to such other equitable or remedial relief as the court may deem appropriate, ..." Contrary to its opinon, ERISA is not silent with respect to the remedy for prohibited transactions. Nor, should the lower court's decision affirming the Northern District provide no remedy and thereby conflict

with existing applicable decisions of this Court. The fact that this Court has never settled the full extent of Section 1109(a) and the probable existence of conflict with applicable decisions of this Court are important reasons to grant certiorari to the Seventh Circuit.

II. THE SEVENTH CIRCUIT DECISION NARROWLY INTERPRETING AND CONSTRUING ERISA SECTION 1109(a) TO PRECLUDE DISGORGEMENT OF PROHIBITED TRANSACTION PROFITS HOLDS IMPORTANT IMPLICATIONS FOR EMPLOYEE BENEFIT PLANS NEVER INTENDED BY CONGRESS AND IN CONFLICT WITH PRIOR TRUST LAW

Unless reversed, the lower court's narrow construction of Section 1109(a) has significant and adverse implications both for the proper administration of qualified employee benefit plans and the federal courts. As observed by the lower court in Leigh I, benefit plans control and enormous pool of capital with extensive investments in securities (Leigh I, at 132, 727 F2d.) Today, "insider trading" by a well meaning fiduciary seeking to maximize the plan's investment portfolio is but one further current concern in the financial markets that easily impacts upon administration of benefit plan assets. The "Engle group" type of corporate raider is another concern that results from the lower court decision. *See, Sandoval* v. *Simmons,* 622 F.Supp. 1174 (D.C.Ill. 1985). Both inside traders and Engle group type corporate raiders may even be honest but imprudent, dishonest but prudent, or dishonest and imprudent. In all instances under the lower court's rationale, the criteria for disgorgement is not the prohibited transactions; or other breach of duty, it is whether there is a loss to the trust. See *Brock v. Robbins, 830 F.2d 640 (7 Cir. 1987).* The apparent but erroneous theory is that "risk of harm" to the trust by the trustee pales in significance to whether there is an actual loss. If there is an actual loss, the loss

must be made up under Section 1109(a). If the fiduciary obtains profits from use of the trust assets, he must restore them. This much is expressly provided by Section 1109(a). However, under the lower court's decision, so long as the plan sustains no loss regardless of the prohibited transactions or profit earned the plan has no remedy. The decision is plainly wrong. It is not and never has been the teaching of this Court's decisions that the loss or gain by the plan is the "linchpin" for relief against a breaching fiduciary.

Moreover, unless reversed the lower court's opinion either portends a move away from traditional trust law which is important to this Court's supervisory power of federal courts; or, it is likely to create conflicts among the circuits over the appropriate interpretation to be given "other equitable relief." The lower court's decision unnecessarily creates a "formidable task" for the federal courts. No federal appellate court has ever applied copyright law concepts of profit attribution to trust law or fiduciary relations seeking to halt breaches of fiduciary duty. Now, however, unless reversed other federal courts may attempt to likewise engraft onto ERISA copyright law concepts of attribution that Congress had since eliminated from copyright law. It is plain this "formidable task" and concern about "windfalls" is misdirected because disgorgement is not punitive damages.

As an initial matter there is no congressional debate to support the lower court's narrow interpretation of Section 1109(a). That section follows the statutory codification of fiduciary duty, a co-fiduciary's duty and enumerated prohibited transactions. It is not intentionally obscure. Unless the lower court's decision is reversed however dishonest or imprudent fiduciaries of every variety are now emboldened to argue with ERISA beneficiaries in the federal courts, if necessary for even ten years, that "good faith", "windfall", "fairness", "no plan losses", "distribution of over one million dollars", and "modern portfolio

and investment strategy" allow them profits from prohibited transactions. The entire concern of Congress expressed for preventing misuse and mismanagement to which this Court referred in *Massachusetts Mutual Life Insurance Company v. Russell, supra, fn 12* is nullified and held for naught for petitioners and all ERISA beneficiaries.

Another important implication arising from the lower court's decision is that for years in cases involving security law violations, disgorgement has been applied to "insider" type cases. The reason is the judiciary seeks to discourge insider trading. *See Securities and Exchange Commission v. Shapiro, 494 F.2d 1301, 1309 (2 Cir. 1974); Securities and Exchange Commission v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1307-1308 (2 Cir. 1971). In Janigan v. Taylor, 344 F.2d 781, 786 (1 Cir. 1965),* the appellate court stated the position desired by the Congress in ERISA: "It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them. . . . It is simple equity that a wrongdoer should disgorge his fraudulent enrichment." Since, this Court has shown no lessening of the importance of disgorgement in security law cases, the lower court in this case should be reversed so that ERISA remains vital and effective.

Congress expressly intended to eliminate the "great personal tragedy" experienced by employees promised a retirement benefit by their employer, but which is lost when the plan is terminated; *Nachman Corporation v. Pension Benefit Guaranty Corporation, 446 U.S. 359, 374, 100 S.Ct. 1723, 64 L.Ed 2d 354 (1980)* or, as petitioners experienced, when Reliable Manufacturing Corporation was shut down by respondents who were engaged in three corporate take over fights involving prohibited transactions. To avoid "great personal tragedy", ERISA even insulates the fiduciary from potential conflicts. *N.L.R.B v. Amax Coal Company, 453 U.S. 322, 333, 101 S.Ct. 2789, 69 L.Ed 2d*

672 (1981). Now, unless reversed, the lower court's decision requires federal district courts throughout the midwest to consider loss to the plan rather than prohibited transactions, obviating the last part of Section 1109(a) which Congress intended to be read and understood as the basis for the equitable remedy of disgorgement. ERISA intentionally incorporated the prophylactic concept of disgorgement for its strict, and even "draconian", effect. Bogert, *Trusts and Trustees*. Section 543 at page 480 (2d ed. 1960) states:

> "The principal object of the administration of the rule is preventive, that is, to make the disobedience of the trustee to the rule so prejudicial to him that he and all other trustees will be induced to keep away from disloyal transactions in the future."

A further and most unwanted implication of the lower court's decision and narrow interpretation of Section 1109a is that the federal courts are now empowered to accept explanations and excuses for the breach of fiduciary duty that were not and have not been accepted in such courts. *In re Beck Industries, Inc. v. Kirschenbaum, 605 F.2d 624, 636-637 (2 Cir. 1979)* the appellate court observed what petitioners urged in the Northern District, namely:

> "It is simply impossible to say that the price to be received by the estate is what it would have been if Ross had not entered into the JVA and concealed Butler's role. Courts do not take kindly to arguments by fiduciaries who have breached their obligations that, if they had not done this, everything would have been the same."

It was this argument which the lower court approved in petitioners' case. As a result, respondents are found to have engaged in prohibited transactions and have been rewarded with nine million dollars. The importance of this unwanted implication from this lower court decision is that it is profitable to breach fiduciary duty and to engage in

prohibited transactions so long as there is some profit to the plan. Another important implication from the lower court is that prohibited transactions that enrich a benefit plan require no sanction. The breaching fiduciary must not be allowed to retain the profits which the finding of a prohibited transaction have produced. Congress never intended to reward a fiduciary that gambles with trust assets (by engaging in a prohibited transaction) and wins himself a profit on his investment and on the plan assets (there is no harm to the trust) or be entitled to retain his profit because the result would have been the same had he not used trust assets. The focus of Section 1109(a) is intentionally not on loss or gain to the plan. *Magruder v. Drury, supra, at 119-120.* It is on preventing "great personal tragedy." *Nachman Corporation v. Pension Benefit Guaranty Corporation, 446 U.S. 359, 100 S.Ct. 1723, 64 l.Ed. 354, (1980).* It must be on preventing misuse and mismanagement of plan assets which this Court observed in *Massachusetts Mutual Life Insurance Company v. Russell, supra.* The focus of Section 1109(a) must never be left on a factual determination that is similar to prior copyright law where the lower court's decision rests.

The lower court's interpretation of ERISA as silent after its finding that respondents had engaged in three prohibited transactions raises important implications for benefit plans never intended by Congress. The implication is that the lower court and thereby all appellate courts that are pursuaded to follow the lower court, are too easily mistaking punitive damages for disgorgement–or a legal remedy for the equitable remedy. It is true in law cases, punitive damages serve only to punish and deter and are generally seen as a windfall to plaintiffs, who are entitled to receive full compensation for their injuries—but no more. *Smith v. Wade, 461 U.S. 30, 59; 103 S.Ct. 1625, 75 L.Ed. 2d 632 (1983)* (Rehnquist, J., dissenting) Yet, it is not punitive damages that petitioners specifically sought in their complaint. What was sought is the deterrent effect

of punitive damages or "other equitable relief" that Congress intended. Disgorgement of respondents' profits from admitted prohibited transactions is not punitive damages. The benefit served by inflicting this risk upon breaching fiduciaries is tailored to deter those who would place the making of risky profit upon the backs of employees who work diligently for the day of retirement. The remedy unlike punitive damages reaches only funds attributable to the breach, it cannot saddle respondents with exemplary damages out of all proportion to respondents' gain. The decision of the lower court has deprived petitioners of this equitable and effective remedy for the plan and it has denied to pensioners all over America the appropriate remedy that Congress intended.

Accordingly, the availability of disgorgement as a remedy for prohibited transactions pursuant to Section 1109(a) is in need of urgent clarification by this Court.

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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